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To be argued by
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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940 — NO. 479

NORMAN J. PFAFF and FRANK B. WALLACE, Executors of Estate of William L. Wallace, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

BRIEF FOR PETITIONERS

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OPINIONS BELOW

The Board of Tax Appeals rendered a memorandum opinion which was not officially reported. The said opinion is printed in the record herein on pages 9 to 11. The Circuit Court of Appeals for the Second Circuit, in a memorandum reported in 113 Fed. (2d) 114, affirmed without opinion.

JURISDICTION

Petitioners invoke the jurisdiction of this Court pursuant to Sec. 240 of the Judicial Code, as amended (28 U. S. C. A., §347) wherein this Court is authorized upon the petition of any party to require by certiorari, either before or after a judgment or decree by such lower Court, that the cause be certified to the Supreme Court for determination by it with the same power and authority and with like effect as if the cause had been brought there by unrestricted writ of error or appeal.

The petition for this writ was presented to this Court Oct. 1, 1940, and was granted on Nov. 12, 1940.

STATEMENT

On August 30, 1937, the Commissioner notified petitioners that he had determined a deficiency tax for the year 1935 (R. 4). Petitioners duly filed their petition to the Board of Tax Appeals for a redetermination (R. 2). A hearing was had before Board Member J. Russell Leech on June 20, 1939. On Sept. 30, 1939, his decision was rendered, affirming the Commissioner's determination (R. 11). Petitioners duly filed a petition for review by the United States Circuit Court of Appeals for the Second Circuit (R. 12-15). The appeal was argued before the Circuit Court. On July 8, 1940, a decision was handed down, affirming without opinion the Board's decision (R. 48).

FACTS

On July 1, 1933, decedent, William L. Wallace, a physician and surgeon, and several other physicians and surgeons, entered into a partnership agreement (Ex. 1 [Adm., R. 17; Pr., R. 38-41]) under which they operated until June 30, 1935. At that time the old partnership was dissolved, a new partner taken in, and a new partnership agreement made, under which decedent and his partners operated until Dec. 25, 1935, when decedent died (Ex. 2 [Adm., R. 17; Pr., R. 41-45]). Both of said partnerships maintained their accounts on a cash basis, as were also the books of decedent (R. 26).

Petitioners filed for the year 1935, the year in which decedent died, an income tax return reporting for all sums which decedent had received or was entitled to receive from the partnerships according to the partnership agreements. In assessing the deficiency against petitioners, the Commissioner claimed

that in this return petitioners should have also included decedent's share of the estimated receipts from all cases which any of the surviving partners were then treating, despite the fact that the proceeds therefrom had not been received by the partnership during 1935; nor had the fees thereon been fixed at the time of decedent's death.

Some of these cases were completed during 1936, the fees then fixed, and collected by the surviving partners. Decedent's share of the sums so collected amounted to $5,189.19 and was paid over to his estate by the surviving partners during the year 1936 (R. 37). On Oct. 1, 1936, decedent's interest in the remaining uncollected accounts was sold at public auction for $500 pursuant to the order of the Surrogate of Onondaga County, the court having jurisdiction of decedent's estate (Ex. 8 [Adm., R. 34; Pr., R. 45, 46]).

These partnership agreements expressly provided that the partnership accounts should be kept on a cash basis and that no partner was entitled to share in the proceeds of the cases under treatment until the fees had been collected and partnership expenses paid therefrom.

No entries were made on the partnership books until the money for the particular service had been received by the partnership (R. 25, 26). A record of services to patients was maintained on a card system (R. 26, 27). As services were rendered an entry was made on one of these cards to show the time and amount of service performed (R. 27). No bills were sent out until the case was completed, and in many cases no charge was ever made and no bill ever sent out (R. 27). Upon the completion of a case, the physician-partner in charge thereof made a flat charge for the entire case and a bill was then sent out to the patient (R. 27).

The books of the partnership showed only expenses actually paid and cash actually received (R. 26). The monthly accountings had, pursuant to paragraphs "Eighth" of each of the partnership agreements, referred only to the cash transactions appearing on the partnership books.

Petitioners contend that decedent's proportionate share of the value of cases under treatment at the date of decedent's death, by the surviving partners, and decedent's distributable share received by petitioners from the surviving partners in 1936 was not taxable income for 1935, but rather taxable as part of decedent's gross estate and that these items did not "accrue" within the meaning of Sec. 42 of the Revenue Act of 1934.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that decedent's share in the receipts for services rendered by these partnerships prior to his death but not received by the partnerships until 1936, after his death, should be considered taxable income to decedent in the year 1935 accruable within the meaning of Sec. 42 of the Revenue Act of 1934.
2. In failing to hold that decedent's share in the receipts for services rendered by these partnerships prior to his death but not received by the partnerships until 1936, after his death, did not constitute taxable income to decedent in the year 1935.
3. In affirming the decision of the Board of Tax Appeals.

POINT I

Upon the dissolution of a partnership by the death of a partner, his interest in the partnership accounts is not taxable income as of the date of such dissolution.

The Commissioner has taxed as income for 1935, the year of decedent's death, the monies received by decedent's estate from the liquidation and collection of partnership accounts in 1936. The partnership was dissolved because of decedent's death.

The Commissioner claims the monies so received to be taxable income under the provisions of the following sections of the Revenue Act of 1934:

> "Sec. 182. Tax of Partners: There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year."
>
> "Sec. 41. General Rule. The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in Section 48, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see Section 22 (c).)"
>
> "Sec. 42. Period in which Items of Gross Income Included. The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods

of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period."

It must be remembered that Sections 41 and 42, supra, are found in Part IV of Subtitle B of the Revenue Act, "General Provisions." This part of the Act is entitled "Accounting Periods and Methods of Accounting." Sec. 182, on the other hand, is in the Supplement devoted to "Taxes on Partners." The only logical conclusion, therefore, is that Sections 41 and 42 are devoted to accounting problems and that Section 182 lays down the law as to when the distributive share of a partner is taxable.

Section 4 of the Act provides in part:

> "Special Classes of Taxpayers: The application of the general provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:
>
> (a) Estates and trusts and the beneficiaries thereof, —Supplement E.
>
> (b) Members of partnerships,—Supplement F.
>
> (c) Insurance Companies,—Supplement G. * * *."

Supplement F, referred to above, is the specific provision in the Act for the computation of the tax on a partner's distributive

share in the partnership profits, and Section 182 falls within that provision. By the very terms of the 1934 Act, therefore, Section 42 is clearly subordinated to Supplement F in matters involving taxes on members of partnerships.

It is clear that Congress did not intend by amending Section 42, supra, to in any way alter the existing law with reference to the taxability of net income to partners from partnerships. The amendment to Section 42 was intended to reach the individual whose salary or income was accrued to him on the books of the corporation or other entity employing him. In the event of his death prior to his withdrawal of such accrued salary or income from the corporation accounts, prior to the change in Section 42, there was no provision by which this item could be taxed as income. It constituted a deduction from the corporation's tax, was not income to decedent's executor and, not having been received by decedent in his lifetime, could not be taxed as income to him. This amendment was passed solely for the purpose of reaching such income. Clearly it was not intended to in any way change the existing law with reference to taxable income to members of partnerships.

The question is, therefore, whether on the dissolution of a partnership by the death of a partner his share in the partnership accounts is taxable as income. From the first enactment of the income tax law in 1913 until the amendment to Section 42 the Commissioner had not taken that position. Petitioners contend that Section 42 has in no way extended to the Commissioner that additional right.

In order, therefore, to determine whether these receipts constituted taxable income, we must determine whether they were decedent's "distributive share * * * of the net income of the partnership for the taxable year" 1935 within the meaning of Section 182.

Paragraphs "Eighth" of the partnership agreements provide that

> "on the first day of each month there shall be an accounting for the preceding month of * * * all partnership gains and losses and there shall be paid to each of said partners, after the deduction of the expenses of said partnership, the proportionate share of the profits of said co-partnership, as hereinbefore specified."

Paragraphs "Sixth" provide that the books of account of the partnerships shall contain a record of

> "all money by them or either of them received, paid out and expended in and about the said business."

Paragraphs "Thirteenth" provide that

> "at the termination of this co-partnership * * * all outstanding book accounts shall be collected at the end of the said co-partnership by them, and all proceeds realized from the collection thereof, less the actual expenses incident to the collection thereof, shall be divided between them * * * ".

in accordance with their respective interests.

At the time of decedent's death there were outstanding a large number of accounts for services rendered to patients (R. 22). No entries were made on the partnership books for these services because it was the practice to make no entry until the money had actually been collected (R. 25, 26). The only record of services performed was kept under a card system upon which the time and amount of service performed was recorded (R. 26, 27). Bills were sent out when the case was completed (R. 27). At the time of decedent's death there was no way of determining even the amount of these accounts be-

cause none had been set up on the partnership books (R. 26), and in many instances the services were not completed (R. 22, 23).

At the time of decedent's death there was absolutely no money allocated on the partnership books as his distributive share (R. 20). Petitioners urge that within the meaning of Section 182 there was no net income taxable to decedent as of the date of his death. Certainly there could be no income, either actually or constructively, received by decedent until the partnership had at least constructively received the income. Can it be said that the record of services performed and contained on this card index system by this partnership could on any given date be considered as income constructively received by the partnership? The pertinent provision of the Regulation in that regard is set forth in Article 42-2 of Treasury Reg. 86, which provides as follows:

> "Income not reduced to possession—Income which is credited to the account or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. * * *"

Decedent's share of the receipts to be collected from the cases then pending and listed on the card index of the partnership could neither be set apart without substantial limitation or restriction, nor be made available to him to be drawn upon by him in 1935.

Article 42-3 of the same Regulation likewise provides for a reference to Section 188 (in Supplement F) of the Act for determining a partner's tax:

> "* * * As to the distributive share of the profits of a partner in a partnership, see Section 188. * * *"

The purpose of the amendment to Section 42 was not to accrue partnership income in computing the tax of an individual partner. Only the income of the decedent need be accrued. An examination of the report of the Ways and Means Committee of the House and of the Finance Committee of the Senate substantiates this position.

The report of the Ways and Means Committee of the House on Sections 42 and 43 (H. Rep. No. 704, 73d Cong., 2d Sess., p. 24) is as follows:

> "Sections 42 and 43. Income accrued and accrued deductions of decedents: The courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death cannot be deducted by the estate. Section 42 has been drawn to require the inclusion in the income of a decedent of all amounts accrued up to the date of his death regardless of the fact that he may have kept his books on a cash basis. Section 43 has also been changed so that expenses accrued prior to death of decedent may be deducted."

The report of the Finance Committee of the Senate on Sections 42 and 43 (S. Rep. No. 558, 73d Cong., 2d Sess., p. 28) is as follows:

"Sections 42 and 43: 'Period for which deductions and credits taken. The courts have held that income accrued prior to the death of a decedent on the cash basis is not income to his estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death can not be deducted by the estate. Sections 42 and 43 of the House bill were so drawn as to require the inclusion in the income-tax return for the decedent of all items of income and deductions accrued up to the date of death regardless of the fact that the decedent may have kept his books on a cash basis. The change made in Section 43 is necessary to effectuate the policy adopted in the House bill in Section 42. By reason of the proposed change such items as accrued dividends and interest on partially tax-exempt securities are permitted as a credit in computing the normal tax."

In discussing this Section, together with the foregoing Committee reports, the Board of Tax Appeals in the case of *Fehrman v. Commissioner*, 38 B. T. A. 37, concluded that the sole purpose of Congress in enacting said Section was to compute a decedent's income on an accrual basis even though he had theretofore kept his books and made his returns on a cash basis.

The courts have often distinguished between partnership income and the income of the individual partner for tax purposes. It has been held that the Government cannot levy on partnership assets because of a tax claim against the individual partner (*U. S. v. Kaufman*, 267 U. S. 408); a partner cannot offset personal non-capital losses against his distributive share of partnership non-capital gains (*Johnston v. Commissioner*, 86 Fed. (2d) 732); the partners and their partnership can have different fiscal years (*Guaranty Trust Co. v. Commis-*

sioner, 303 U. S. 493), and the partners and their partnership can have different methods of accounting (*Truman v. U. S.*, 4 Fed. Supp. 447; Percival H. Truman, 3 B. T. A. 386; W. J. Burns, 12 B. T. A. 1209; Fritz Hill, 22 B. T. A. 1079).

The Commissioner contends that one of the reasons why his determination of the deficiency should be upheld is that otherwise this particular sum might escape taxation altogether. This is not so, for it is taxable as part of decedent's gross estate. Furthermore, the fallacy of such argument is pointed out in Mertens' "Law of Federal Income Taxation," 1939 Supp., Sec. 4.01, p. 537:

> "It is sometimes urged as a reason for taxability that unless an item is taxed it will escape taxation altogether. This is a question-begging argument if the point to be determined is whether an item is income at all."

As authority the author cites *Commissioner v. Norfolk Southern Railroad Co.*, 63 Fed. (2d) 304, Cert. Den., 290 U. S. 672.

The 16th Amendment, upon which the present income tax is based, authorized a tax on "incomes from whatever source derived." It has been held that either the accrual or the cash method of determining income was permissible. It is extremely doubtful, however, whether such a combination of these methods as the Commissioner seeks to impose upon petitioners under Section 42 accurately determines taxable income within the authorization conferred by the 16th Amendment. As interpreted by the Commissioner, Section 42 would require that taxpayer file a return accounting for all income on a cash basis and superimpose thereon additional items computed on the accrual basis. It is difficult to see how the figure thus arrived at could be held to constitute income within the meaning of the 16th Amendment. The opinion of this Court in *Guaranty Trust*

Co. v. Commissioner, 303 U. S. 493, substantiates petitioners' position in this regard. Mr. Justice Stone therein states:

> "Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it, nor the duration of his investments which have finally resulted in profit."

It is to be noted that the Court used the terms "receipt of income" and "accrual of the right to receive it" in the alternative.

Much has been made of the fact that because of decedent's death the partnerships were automatically dissolved, pursuant to the Partnership Law of the State of New York, and that therefore decedent's interest in the partnership accounts became immediately distributable to him. Upon a careful study the fallacy in this argument becomes evident.

The pertinent sentence of Section 42 reads in part that:

> "* * * there shall be included * * * amounts accrued up to the date of his death."

Certainly decedent's share of the partnership accounts could not have accrued up to the date of his death if, as the Commissioner contends, they became distributable upon his death.

In a recent case, *Golden v. Commissioner of Internal Revenue,* 113 Fed. (2d) 590, the Commissioner extended this contention to its logical conclusion and it was there declared untenable by the Court. In that case the decedent was a large stockholder as well as an official of the Golden-Anderson Valve Specialty Co. The company maintained large insurance policies upon its executive officials which were, pursuant to an

agreement, to be distributed when collected directly to the stockholders in proportion to their holdings. Upon the death of Golden this insurance was collected and a large portion paid over to his estate as a stockholder in the company. The Commissioner contended that the proceeds of the policy payable to decedent's estate constituted income accrued to him under Section 42 which should have been reported by the executors in decedent's last return. The Court stated:

> "One minor question remains. Mr. Golden, the insured president of the Valve Company, held, as might be expected, a large portion of its stock. Did his insurance dividend accrue to him individually in the period before his death, or to his estate in the period after his death? The Board's allocation of the dividend to the latter period is, we think, plainly correct. 'All events creating the liability' for that dividend had assuredly not occurred prior to Mr. Golden's death, or even—to split a metaphysical hair—up to and including the moment of his death."

The dissolution of the partnership because of the death of Dr. Wallace can have no bearing upon the taxability of the sum in question as income for the year 1935, as any interest which might accrue to him by reason of such dissolution could not have accrued "up to the date of his death."

POINT II

Assuming that Section 42 applies to petitioners herein, there was no income accrued to decedent as of the date of his death on December 25, 1935.

The partnership agreements specifically provided for an accounting and payment of distributive shares to the partners at

monthly intervals. This was done down to the month of December, 1935. On the date of decedent's death there was no distributive share in the partnership profits on hand due to decedent or to any other partner. True, the partnership had as assets certain accounts for services rendered and certain prospective accounts for medical services rendered for which no fee had then been fixed, but such cannot constitute income in any system of accounting. The fact that in the case of a deceased taxpayer the accrual method of accounting is forced by statute upon the executor of his estate does not mean that the accrual method of accounting is forced upon the partnership of which he was a member.

Several cases decided by the United States Courts indicate most clearly that neither the sum here sought to be taxed as income nor the right to receive it had accrued to decedent at the time of his death in December, 1935. In *Guaranty Trust Co. v. Commissioner,* 303 U. S. 493, this Court stated:

> "Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it, nor the duration of his investments which have finally resulted in profit. *Lucas v. Alexander,* 279 U. S. 573.
>
> The Revenue Acts have consistently adhered to that policy in taxing the income of a partner. Since the partner is entitled to profits only upon a partnership accounting at the end of the accounting period, his profits become subject to income tax when and as they are thus ascertained."

Unless the income was actually received by decedent before his death, or his right to receive it pursuant to the terms of the partnership agreements had accrued to him at that time, under

the rule in the case of *Guaranty Trust Co. v. Commissioner,* 303 U. S. 493, it was not taxable income during that tax year. The Commissioner makes no contention that decedent received this income during 1935. Neither was he entitled to receive it. The Commissioner, however, contends that regardless of these considerations, under Section 42, it became "taxable accrued income" upon the day of decedent's death.

The sum herein involved never came into decedent's possession. At no time could he have used the proceeds of the partnership accounts. All the money realized therefrom might conceivably have been paid out for equipment or for other partnership expenses. No part of the partnership funds was decedent's until at one of the monthly accountings the partners divided among themselves whatever part of the cash on hand remained over and above the authorized expenses. Until that division had been made no income could accrue to any of the individual partners.

Many Courts have held many times that income "accrues" only when it is credited to the taxpayer and becomes subject to his disposal without restriction. The Court so stated in *Simms Oil Co. v. Commissioner,* 74 Fed. (2d) 561:

> "Article 51 of Reg. 69, promulgated under the Revenue Act of 1926, followed the well settled principle that income accrues only if it is credited to the taxpayer and becomes subject to his disposal without restriction."

The Commissioner, in construing decedent's share of the accounts receivable of the partnership to be income taxable to decedent as of the date of his death, based such determination, not on facts ascertainable at the time of death, but upon the facts determined between the time of decedent's death and the assessment of the deficiency. The Commissioner, in assessing the deficiency, adopted as the basis for the assessment the ap-

proximate receipts of the estate for the subsequent year (1936). This very fact serves to show the impossibility of determining accurately the value of accounts receivable at the time of decedent's death. Such determinability is a primary test of accruability.

In *Helvering v. Russian Finance & Construction Corp.*, 77 Fed. (2d) 324, the Court in discussing the accruability of deductions, stated:

> "In order to be accruable in the taxable year for which the return is made, a valid obligation to pay must have existed in that year, which is enforceable on the date when the obligation is due. When, however, the obligation to pay is contingent upon the happening of some future event, there is no certainty that it will be paid or will accrue. In such event, no obligation accrued from the fixed or determinable source and no duty arises or exists in the taxable year which can be accounted for as income under any system of accounting."

After studying the problem of accrual of income and discussing thoroughly the various definitions of the word accrue, the Ninth Circuit Court in *H. Liebes & Co. v. Commissioner*, 90 Fed. (2d) 932, concludes:

> "The complete definition would therefore seem to be that income accrues to the taxpayer when there arises to him a fixed or unconditional right to receive it if there is a reasonable expectancy that the right will be converted into money or its equivalent."

Decedent had no fixed or unconditional right to receive the sum in question; even the partnership did not receive it until the year 1936. At the time of decedent's death in 1935 many contingencies intervened before the monies were to be received by the partnership and after it had been received by the part-

nership much still remained to be done before any could be allocated to decedent or his estate as part of his distributive share. These items therefore cannot meet the definition of accrued income as construed in the cases herein cited.

In *Commissioner v. Edwards Drilling Co.*, 95 Fed. (2d) 719, the Court in the Fifth Circuit stated in this regard:

> "It is, of course, true as the Board points out that under the accrual method of accounting employed by petitioner, items must be accrued as income when the events occurred to fix the amount due and determine liability to pay. *United States v. Anderson*, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347. Generally speaking, however, the income tax law is concerned, and its administration should deal only, with realized losses and realized gains. *Lucas v. American Code Co.*, 280 U. S. 445, 50 S. Ct. 202; 74 L. Ed. 538, 67 A. L. R. 1010. The taxpayer therefore is under no obligation to pay a tax on income he might never receive. *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197. A strained construction in administrative efforts to accrue income should be avoided."

Petitioners' position is further supported by the decision of the Board of Tax Appeals in *Fehrman v. Commissioner*, 38 B.T.A. 37. There, the petitioner's decedent, reporting on a cash basis, received from his employer in addition to his salary a certain percentage of the net profits of the store as disclosed by inventory at the end of the calendar year. Decedent died August 14, 1934. His employer ascertained the percentage of profit due to decedent and paid the same to his estate January 1, 1935. In holding that the sum thus paid did not accrue to decedent during the period ending on the date of his death and

was not properly includible in his gross income for that period, the Board stated:

> "It is obvious from the language of the Act and the Legislative intent as disclosed by the Committee reports quoted above, that the purpose of Congress was to treat the income of a decedent as though he were on an accrual basis even though he was actually on a cash basis and kept his books on a cash basis, and that the phrase 'amounts accrued up to the date of his death' means those amounts which would be properly included in a decedent's income if he were on an accrual basis as distinguished from a cash basis.
>
> If petitioner's decedent had been on an accrual basis rather than a cash basis, would the amount paid to the petitioner by the F. W. Woolworth Co. in January, 1935, be properly considered as income accrued to the decedent at the date of his death? It is our opinion that it would not."

The Commissioner claims this case to be distinguishable because of its different factual setup. Petitioners contend, however, that the principles upon which that opinion was based are likewise applicable to the present case. The Board there held that to constitute accrued income to a taxpayer such amounts must be definitely ascertainable at the time as of which the accrual is to be made and the exact amount of compensation be a mere matter of computation. Applying that principle to the present case, it is clear that more than mere computation was necessary in order to determine the sum due decedent from the partnership.

A case analogous to the present is that of *United States v. Wood*, 79 Fed. (2d) 286, Cert. Den., 296 U. S. 643. There decedent was, as in the present case, a member of a partnership.

The partnership continued pursuant to its agreement after decedent's death and at the end of the year decedent's estate was credited with his share in the partnership profits for the portion of the year prior to his death. The Commissioner cited as authority for his position that said income was taxable as of the year of decedent's death, the case of *Darcy v. Commissioner*, 66 Fed. (2d) 581. In distinguishing this case the Court in *U. S. v. Wood*, supra, quoted from the Darcy case and commented thereon thus:

> "The Circuit Court of Appeals said, 'We agree that what is not income in fact cannot be made income by legislative fiat and thus brought within the Income Tax Laws. *Hoeper v. Tax Commission*, 284 U. S. 206, 215; 52 S. Ct. 120; 76 L. Ed. 248. But this actually was decedent's income. For all we know he could have had it as such before he died. He did draw a comparatively small amount between January 1, 1924, and the date of his death. No one can say from this record that he drew all he could.'
>
> In the instant case no partner had the right to demand any part of the profits until the end of the calendar year. In fact, because of the nature of the partnership business the profits could not be determined until that time."

The Court thereupon directed judgment for the taxpayers.

The Circuit Court in the Third Circuit in a companion case to the one at bar, *Enright's Estate v. Commissioner of Internal Revenue*, 112 Fed. (2d) 919, declared that Section 42 did not authorize the assessment of a deficiency in a parallel situation to the present. The Court there stated:

"In the present case under the partnership agreement as reflected in the partnership accounts and returns, Enright had the right to receive only his proportionate share of the cash receipts of the firm. Of these only $4,143.81 remained distributable to him at his death. We think it is clear from what has been said that this sum represented the partnership income accrued to him up to the date of his death within the meaning of Section 42 of the Revenue Act. In our opinion that section did not require the inclusion as 'amounts accrued' of the uncollected accounts receivable and unbilled fees which under the partnership agreement and its accounting method were not distributable to him."

Petitioners accounted for all income which decedent had received from the partnerships. He was entitled to no more at the date of his death. The deficiency assessed is based upon receipts from the partnership received in 1936 and resulting from winding up its affairs. This, petitioners submit, was error.

A further analogy supporting the holding sought by petitioners is found in the decisions involving the return of income impounded pending the disposal of litigation. *North American Oil Consolidated v. Burnet*, 286 U. S. 414, 423; Trojan Oil Co., 26 B.T.A. 659; National Petroleum & Refining Co., 28 B.T.A. 569. In the North American Oil Consolidated case, supra, this Court held impounded income taxable in the year in which it was actually received. Mr. Justice Brandeis stated:

"The net profits were not taxable to the company as income of 1936 * * *. There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the Receiver pay over the

money. Throughout 1916, it was uncertain as to who would be declared entitled to the profits. It was not until 1917, when the District Court entered a final decree vacating the Receivership and dismissing the bill, that the company became entitled to receive the money. Nor is it material for the purposes of this case, whether the company's return was filed on cash receipts and disbursements based on an accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive."

The Commissioner submits as authority for his position two recent decisions of this Court: *Bull v. U. S.*, 295 U. S. 247, and *Guaranty Trust Co. v. Commissioner*, 303 U. S. 493. Petitioners have already cited from the opinion in the latter of these two cases as authority for their position. Petitioners submit that neither decision conflicts with their contention herein.

In *Bull v. U. S.*, 295 U. S. 247, no question of accrual was presented. This Court decided that decedent's share of the partnership profits for the portion of the year during which he lived constituted income to him. His share of the profits for the balance of the year was treated as income to his estate. The distinction between that case and the present is clear. The main question in the instant case, whether money received subsequent to decedent's death for work done prior to his death, constitutes income, was not involved. The Court there was concerned solely with profits actually received by the firm prior to and subsequent to the partner's death.

Similarly, in *Guaranty Trust Co. v. Commissioner*, 303 U. S. 493, this Court was concerned only with the taxability of profits received by the firm during the part of the year prior to decedent's death. The question of taxability as income of the

subsequent receipts from accounts for incomplete and unbilled services was not at issue in that case.

On the date of decedent's death the partnership had no assets capable of distribution among the partners in proportion to their respective interests in the partnership. No one could possibly have parceled out the cases indexed on the record cards and say to each partner—"This is your share." The fee to be charged had not been fixed and could only be fixed by the physician in charge of that particular case, not by the partner who might receive that case if such a distribution were attempted. In the event of such distribution one partner might collect one hundred percent on the cases set apart for him, another twenty percent, or perhaps nothing. Such would not be an equitable distribution of partnership assets. In order to effect a proper distribution according to the terms of the partnership agreements it was essential that none of the assets be distributed until they had been liquidated.

POINT III

The decision of the Circuit Court of Appeals for the Second Circuit should be reversed and the deficiency assessed by the Commissioner against petitioners should be set aside.

Respectfully submitted,
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